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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938.

No. 212

SOUTHERN PACIFIC COMPANY (A CORPORATION),
Appellant,

vs.

JOHN C. CORBETT, FRED E. STEWART, RICHARD E. COLLINS, WILLIAM G. BONELLI AND HARRY B. RILEY, AS MEMBERS OF THE STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA; STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA AND U. S. WEBB, THE ATTORNEY GENERAL OF THE STATE OF CALIFORNIA,
Appellees.

STATEMENT AS TO JURISDICTION.

This is an appeal from a final decree of a District Court of the United States specially constituted pursuant to Section 266 of the Judicial Code, denying a permanent injunction and dismissing the bill of complaint.

The suit was brought by the appellant in the United States District Court for the Northern District of California, Southern Division, to enjoin State officers—the

State Board of Equalization of the State of California and its individual members, and the Attorney General of the State—from enforcing the California Use Tax Act of 1935 (Cal. Stats. 1935, p. 1297, ch. 361) with respect to property purchased by appellant outside the State and used by it in the State of California and in other States in the operation of its inextricably intermingled interstate, foreign and intrastate railroad transportation business. The injunction is prayed upon the ground that the statute, as sought to be applied by appellees with respect to the property in question, is repugnant to the commerce clause of the Constitution of the United States and in violation of the Fourteenth Amendment to the Constitution of the United States.

The appellant pressed its application for an interlocutory injunction, and the court, specially constituted of three judges, denied appellees' motion to dismiss the bill of complaint and granted the application for interlocutory injunction. The opinion on the motion to dismiss the bill of complaint and the application for interlocutory injunction is reported at 20 F. Supp. 940, and a copy thereof is appended hereto as Appendix A.

Appellees answered and the facts were stipulated. Upon final hearing the court made findings of fact and conclusions of law, denied a permanent injunction and dismissed the bill. A copy of the court's opinion upon the final hearing is appended hereto as Appendix B. This opinion is as yet unreported.*

Jurisdiction of the District Court.

This is a suit of a civil nature in equity, between citizens of different States,[1] in which the amount of the taxes the

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* Since the presentation and filing of the jurisdictional statement, this opinion has been reported at 23 Fed. Supp. 193.

[1] Southern Pacific Company is a Kentucky corporation and all defendants are residents of California.

collection of which is sought to be enjoined exceeds $3,000,[2] and the suit arises under the Constitution of the United States.

Notice of hearing of appellant's application for interlocutory injunction was duly given in accordance with Section 266 of the Judicial Code (United States Code, Title 28, Sec. 380), including notice to the Governor of the State of California and the Attorney General of the State of California.

The bill of complaint alleged facts showing that appellant would be irreparably injured if the injunction should not be granted, and showing that appellant was without a plain, speedy or adequate remedy at law, or in equity in the State courts, and particularly that the appellant was without any remedy at law in the Federal courts.[3] The District Court sustained its equity jurisdiction on the ground last mentioned, the only ground which it found necessary to consider (see opinion, Appendix A).

It is well settled that in suits not controlled by the 1937 amendment to Section 24 of the Judicial Code, the want of

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[2] The amount of taxes claimed to be due at the time the suit was commenced was $47,705.72. The complaint asks an injunction against the collection of these taxes and of the taxes for each subsequent quarterly period for which appellees claim that a tax is due under the provisions of the California Use Tax Act. Taxes claimed to be due up to the time of the final decree amounted to $402,020.92.

[3] The bill of complaint in this case was filed July 10, 1936. The Act of Congress of August 21, 1937 (c. 726, 50 Stat. 738), amending section 24 of the Judicial Code, which now provides that no district court shall have jurisdiction of any suit to enjoin, suspend or restrain the assessment, levy or collection of any tax imposed by or pursuant to the laws of any State where a plain, speedy and efficient remedy may be had at law or in equity in the courts of such State, expressly provided that its provisions should not apply to suits commenced prior to its passage.

a remedy in the Federal courts is a ground of Federal equity jurisdiction.

City Bank Co. v. *Schnader* (1934), 291 U. S. 24, 29;
Risty v. *Chicago, R. I. & Pac. Ry. Co.* (1926), 270 U. S. 378, 388;
Chicago, B. & Q. R. R. v. *Osborne* (1924), 265 U. S. 14, 16;
Smyth v. *Ames* (1898), 169 U. S. 466, 515-517.

The Jurisdiction of the Supreme Court of the United States.

As above stated, this is a direct appeal from the final decree of a specially constituted court of three judges, denying a permanent injunction in a suit brought to restrain State officers from enforcing a State statute. This Court has jurisdiction under Sections 238(3) and 266 of the Judicial Code (United States Code, Title 28, Secs. 345 and 380).

The following cases sustain the jurisdiction of this court:
Stratton v. *St. Louis S. W. Ry.* (1930), 282 U. S. 10, 14, 16;
Sterling v. *Constantin* (1932), 287 U. S. 378, 393-394;
Coverdale v. *Arkansas-Louisiana Pipe Line Co.* (1938), —U. S. —, 58 S. Ct. 736, 738.

The State Statute, the Validity of Which is Involved.

The California statute the enforcement of which is sought to be enjoined in this suit is the California Use Tax Act of 1935, Cal. Stats. 1935, p. 1297, ch. 361. Since this suit was commenced, the statute was amended, in particulars not pertinent to this suit except as hereinafter specified, by Cal. Stats. 1937, pp. 1327, 1874 and 1935, chs. 401, 671 and 683. Section 3 of the act, so far as material, provides:

> "An excise tax is hereby imposed on the storage, use or other consumption in this State of tangible personal

property purchased from a retailer on or after July 1, 1935, for storage, use or other consumption in this State at the rate of three per cent of the sales price of such property.

"Every person storing, using or otherwise consuming in this State tangible personal property purchased from a retailer shall be liable for the tax imposed by this act, and the liability shall not be extinguished until the tax has been paid to this State; * * *."

Section 2(a) defines "Storage" as "any keeping or retention in this State for any purpose except sale in the regular course of business of tangible personal property purchased from a retailer." Section 2(b) defines "Use" as "the exercise of any right or power over tangible personal property incident to the ownership of that property, except that it shall not include the sale of that property in the regular course of business." Section 2(j) defines "In this State" as "within the exterior limits of the State of California, and includes all territory within such limits owned by or ceded to the United States of America."

Section 4 contains a number of exemptions, among which are, (a) property, the gross receipts from the sale of which are taxed by the California Retail Sales Tax Act (Cal. Stats. 1933, ch. 1020) and (b) property, the storage, use or other consumption of which the State is prohibited from taxing under the Constitution or laws of the United States or under the Constitution of California. The effect of the first exemption in Section 4 is to make the use tax applicable only to tangible personal property purchased outside the State or in interstate commerce.

Section 6 requires every retailer maintaining a place of business in the State and making sales of tangible personal property for storage, use or other consumption in the State, to collect the tax from the purchaser at the time of making the sales. Section 7 makes the tax due and payable quar-

terly to the State Board of Equalization on or before the 15th day of the month next succeeding each quarterly period, the first quarterly period being that which commenced July 1, 1935. It also requires every retailer maintaining a place of business in the State to file with the Board, on or before the 15th day of the month following the close of each quarterly period, a return for the preceding quarterly period in the form prescribed by the Board, showing the total sales price of the tangible personal property sold by the retailer during the preceding quarterly period, the storage, use or consumption of which is subject to the tax imposed by the act; and to accompany the return by a remittance of the amount of the tax required to be collected by the retailer during that period. If the property is purchased from a retailer not maintaining a place of business in the State, the purchaser is required to file the return and remittance.

Section 8 imposes a penalty of ten per cent, plus interest of one half of one per cent per month, or fraction thereof, for failure to pay the tax or make the return.

Section 20 provides for a summary judgment for the amount of unpaid taxes in favor of the State and against the retailer or other person required to pay the tax, and permits the Board to seize the property of delinquents and sell it at public auction for the amount of the tax, interest, penalties and costs. Section 28 permits the Board to bring suit at any time within three years after any amount has become due and payable and has become delinquent, and a certificate of the Board showing the delinquency is made *prima facie* evidence of the determination of the amount due, of the delinquency, and of the compliance by the Board with all the provisions of the act in relation to the computation and determination of the amount.

Section 30 makes any retailer or other person failing or refusing to furnish a return, or supplemental return or

other data required by the Board, guilty of a misdemeanor and subject to a fine of not exceeding $500 for each offense. Section 31 makes any violation of the act, except as otherwise therein provided, a misdemeanor and punishable as such.

Section 29 (Section 25 since the 1937 amendment) forbids the issuance of any injunction or writ of mandate or other legal or equitable process in any suit, action or proceeding in any court against the State or any officer thereof to prevent or enjoin the collection of the tax or any amount of tax imposed by the act. The only remedy afforded to the taxpayer is to pay the taxes under verified protest, setting forth the grounds of objection to the legality thereof, and thereafter to bring a suit against the State Treasurer in the State Superior Court in Sacramento County to recover the amount of the taxes. The period of limitation for such suits is sixty days (since the 1937 amendment—one year). The superior court is forbidden to consider any grounds of illegality other than those set forth in the protest filed at the time of the payment of the tax. If judgment in such action is rendered for the plaintiff, the amount of the judgment is first to be credited on any taxes or amounts due from the plaintiff under the act, and the balance of the judgment is to be refunded to the plaintiff, with interest allowed at the rate of six per cent per annum upon the amount found to have been illegally collected, from the date of payment to the date of allowance of credit on account of the judgment or to a date preceding the date of the refund warrant by not more than thirty days, such date to be determined by the Controller (since the 1937 amendment, by the Board). The act prohibits any judgment in any such action when it is brought by or in the name of an assignee of the retailer or other person paying the tax, or by any person other than the person paying the tax.

The Questions Involved are Substantial.

The appellant is engaged exclusively in inextricably intermingled interstate, foreign and intrastate railroad transportation business. The property in question is purchased by the appellant with railroad operating capital for the sole purpose of using it in that business and much of the property is especially designed and manufactured for railroad purposes and is either unfit for any other purposes or cannot be economically used for any other purposes. All of the property is for current railroad uses in California and in other States, and much of it, consisting of railroad materials and supplies, is required to be distributed over plaintiff's lines of railroad within the State of California and in other States for repairs, uses and consumption in such railroad operations and for emergency purposes.

The tax is a flat-rate tax upon the storage, use or other consumption of such property, measured by 3% of the purchase price, without apportionment to take into account the division of use between intrastate, foreign and interstate commerce or to take into account the apportionment of undivided and indivisible uses by the railroad as between the State of California and other States in which appellant operates its railroad business.

Under the doctrine of *Helson and Randolph* v. *Kentucky* (1929), 279 U. S. 245, which was reaffirmed in *Bingaman* v. *Golden Eagle Lines* (1936), 297 U. S. 626, and was recognized in *Coverdale* v. *Arkansas-Louisiana Pipe Line Co.* (1938), — U. S. —, 58 S. Ct. 736, State statutes taxing the use of property in interstate commerce for the operation of instrumentalities of interstate commerce are unconstitutional as in violation of the commerce clause.

Under *Cooney* v. *Mountain States Tel. Co.* (1935), 294 U. S. 384, a State excise tax cannot validly be applied in-

discriminately and without apportionment to an instrumentality common to interstate and intrastate commerce.

The appellant contends that the use of the property in question, being indiscriminately in interstate, foreign and intrastate commerce, cannot constitutionally be subjected to the flat-rate, unapportioned tax in question; that the holding of stand-by facilities, materials and supplies, is an indispensable, integral part of the conduct of its inextricably intermingled interstate, foreign and intrastate commerce and business; and that no use, storage or other consumption of the property occurs in California which is not a part of such commerce; and that the taxation of appellant's use of property which is inseparably used in the transaction of its railroad business both within and without the State of California, is extra-terriorial in its effect and is not only a direct and undue burden on interstate and foreign commerce but in violation of the due process clause of the Federal Constitution.

The District Court, duly constituted of three judges in accordance with Section 266 of the Judicial Code, upon the appellees' motion to dismiss the bill of complaint and the appellant's application for an interlocutory injunction, held that the use, keeping, retention or storage of the property which occurred in the State of California was a use in interstate commerce and was not taxable by the State, and that the case was not controlled by the decisions in *Nashville, C. & St. L. Ry.* v. *Wallace* (1933), 288 U. S. 249, and *Edelman* v. *Boeing Air Transp.* (1933), 289 U. S. 249 (see Appendix A). On final hearing the District Court, duly constituted of three judges as aforesaid, reversed its conclusion, holding that although the stipulated facts sustained the pertinent allegations of the bill, discussed in its former opinion, and although the use of the property was a use in interstate commerce, the threatened enforcement of the taxing statute would not impose a direct or undue

burden on the appellant's interstate commerce business (see Appendix B).

This Court has never specifically decided (although appellant contends that the *Helson, Bingaman* and *Cooney* cases, *supra,* are decisive of this case) whether a use tax, measured by a fixed percentage of the purchase price of property without apportionment according to the division of use in intrastate and interstate and foreign commerce, and imposed directly upon (a) the use in inextricably intermingled interstate, foreign and intrastate commerce or (b) the installation or (c) the retention for stand-by purposes, of special equipment, materials, supplies, etc., which are purchased by a railroad company engaged exclusively in inextricably intermingled interstate, foreign and intrastate commerce for use exclusively in that business, or which is manufactured specially for and dedicated exclusively to and is not divertible from that business, and which is used exclusively and necessarily in the conduct of that business and commerce, within the taxing State, and a substantial part thereof inseparably and indivisibly in other States, contravenes the commerce clause or the due process clause of the Federal Constitution.

The questions presented, we submit, are substantial.

The Date of the Decree Sought to be Reviewed, etc.

The final decree of the District Court which is herein appealed from was signed and filed June 14, 1938. The application for appeal was presented June 20, 1938.

Dated June 20, 1938.

Respectfully submitted,

GUY V. SHOUP,
HARRY H. MCELROY,
Attorney for Appellant.

APPENDIX "A".

IN THE SOUTHERN DIVISION OF THE UNITED STATES DISTRICT COURT, IN AND FOR THE NORTHERN DISTRICT OF CALIFORNIA.

In Equity.

No. 4055-S.

Southern Pacific Company, a Corporation, *Plaintiff*,

v.

John C. Corbett, Fred E. Stewart, Richard E. Collins, Ray L. Edgar, and Ray L. Riley, as Members of the State Board of Equalization of the State of California; State Board of Equalization of the State of California, and U. S. Webb, the Attorney General of the State of California, *Defendants.*

Before Denman, Circuit Judge, and St. Sure and Roche, District Judges.

Denman, *Circuit Judge:*

This case involves the question whether the necessary incidental storage of materials bought by an interstate railway company for installation in the service of repair and replacement under a predetermined plan for the maintenance and improvement of the service, is a use in interstate commerce. The State of California, under a general tax law applying to all persons storing within the state goods purchased without the state upon which goods no state sales tax has been paid, seeks to have included in the large number of persons subject to the statute those engaged in commerce among the states.

By the logically immediate process of federal law, the tax on these materials stored for current repairs, operation, etc., of the interstate railway is translated into the passenger fares and merchandise carriage rates of all the passengers and shippers of the thirty or forty states ship-

ping into and out of California.[1] The persons interested in and affected by our decision, though not appearing here, are those upon whom the tax will certainly fall. Though not litigants, their interest transcends that of the corporation and its stockholders.

The Constitution gives to Congress the regulation of the management of interstate railways. If the court decides that this storage of materials is not a use in interstate commerce, then the Congress may not declare it to be or regulate it as such a use. If Congress desires to require the railways to keep in storage for current use such necessary materials it can do so only by invading intrastate activities under an extension of the principles laid down in Nat. Labor Rel. Board *v.* Jones & Laughlin Steel Co., 81 L. ed. 563 and Edwards *v.* U. S. (C. C. A. 9) No. 8386, decided July 22, 1937. The delicate question of the boundary between state and federal power would seem to make proper the presence of the Attorney General of the United States, although the recent legislation requires the opportunity for his presence only where there is presented the constitutionality of a federal statute.[2]

This is a suit in equity brought before a court of three judges pursuant to section 266 of the Judicial Code[3] seeking to have enjoined pendente lite and permanently the enforcement of a statute of the State of California, namely the Use Tax Act of 1935.[4] The defendants are the California State Board of Equalization, the individual members of the board, and the Attorney General of the state. The injunctions are sought on the grounds that the enforcement of the tax in this case will unduly burden the plaintiff's interstate commerce business contrary to the provisions of Article I, section 8, of the Federal Constitution, and that there exists for the plaintiff no adequate remedy at law.

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[1] Taxes are, of course, taken into account in determining a carrier's operating expenses or property valuation for rate fixing purposes. See N. Y. etc., Ry., 97 I. C. C. 273; Great North. R. Co., 133 I. C. C. 1.

[2] H. R. 2260, approved August 25, 1937.

[3] Act of June 18, 1910, 36 Stat. 557, 28 U. S. C. A. sec. 380.

[4] Cal. Stats., 1935, ch. 361.

A temporary restraining order against the enforcement of the tax has been issued. The matter is now before this court on the plaintiff's prayer for interlocutory injunction and the defendants' motion to dismiss the bill. In support of their motion to dismiss the defendants contend that the plaintiff has an adequate remedy at law and that the bill states no ground of relief whatsoever.

Under the assailed tax measure, later considered in detail, the defendants seek to impose against the Southern Pacific Company an excise tax upon the "storage" or "use" of personal property purchased by the company without the State of California, shipped to points within the state and there held, in accordance with predetermined plans, to be installed and made an active part of the company's tangible equipment used within the state for purposes of its inextricably interwoven interstate and intrastate commerce.

The Southern Pacific Company is a corporation of Kentucky engaged as a common carrier by railroad in seven states, including California. Half of its more than 8,000 total mileage is in California. Its gross operating revenue for the calendar year 1935 was more than $124,000,000 of which $63,000,000 was earned on California business. Of this latter figure over $34,000,000 was attributable to interstate commerce.

The specific personal property against the use of which the excise is sought to be enforced consists of a great variety of material necessary for the conduct of plaintiff's intermingled interstate and intrastate business. A portion of it was purchased for integration in plaintiff's railroad system pursuant to an existing maintenance program for the year 1936. The remainder was acquired to have on hand for the recurring demands of maintenance and emergency requirements. Among other articles the property purchased included rails, frogs, switches, valve oil, lumber, stationery and tools. The complaint alleges that the greater portion was specifically designed for use in the operation, maintenance and repair of the road, or "peculiarly adapted to railroad uses * * * and * * * not suitable for any other use." The articles were all required for the efficient and economical conduct of the road.

Concerning the interstate commerce purposes of these purchases, the complaint alleges:

> "Said purchases were made by the plaintiff through the use of its operating capital consisting of money or current assets definitely devoted to the service of transportation, or through the credit of said plaintiff as a railroad engaged in the service of transportation and upon the purchase of said materials and the payment therefor, the expenses therefor are in due course charged into the operating expenses of said carrier to the appropriate accounts for operation, maintenance or repairs, according to the accounting rules and regulations prescribed for railroads engaged in interstate commerce under the provisions and requirements of the Interstate Commerce Act, and that all of said items of tangible personal property so purchased by the plaintiff were devoted to the service of transportation immediately upon their purchase and that upon the purchase of said articles they immediately became a necessary and indispensible part of working capital, material, supplies, equipment and instrumentalities for the operation of said railroad and the said articles and each and all of them became, were and are instrumentalities used indiscriminately and inseparably in the operation, maintenance and repair of plaintiff's railroad for conducting interstate transportation and intrastate transportation from the time the same were purchased therefor, and any storage, use or consumption thereof, which occurred within the State of California cannot be separated or segregated as between intrastate and interstate transportation, the said railroad contemporaneously carrying by means of the same organization and facilities, both intrastate and interstate commerce and said items and materials being from the time of purchase outside the State of California inextricably devoted to and used in service of both classes of commerce."

And further:

> "• • • that prior to any keeping or retention of said materials within the State of California, said ma-

terials were allocated and dedicated to sole and exclusive use in interstate commerce and any keeping or retention thereof within the State of California was and is an inseparable part of the use of said materials and each item thereof in interstate commerce."

The gravamen of these allegations is thus perceived to be that any "keeping" or "storage" of the property within the state is a *use* of the property in interstate commerce preparatory to a *subsequent use* by way of actual physical consumption.

During the three months ending June 30, 1936, the property described in the complaint, purchased outside of and shipped into California, amounted to $1,590,190.62. The use tax assessed on this material totals $47,705.72.

The Act in question imposes an excise tax of three per cent of the sale price upon the storage, use or other consumption of tangible personal property within the state.[5] Leaving out of account the alleged character of the properties as instrumentalities of interstate commerce, the plaintiff's exercise of uses incidental to ownership over them within the state comes within the broad definitions of the statute.[6]

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[5] Cal. Stats., 1935, ch. 361.

"SEC. 3. An excise tax is hereby imposed on the storage, use or other consumption in this State of tangible personal property purchased from a retailer on or after July 1, 1935, for storage, use or other consumption in this State at the rate of three per cent of the sales price of such property.

"Every person storing, using or otherwise consuming in this State tangible personal property purchased from a retailer shall be liable for the tax imposed by this act * * *."

[6] SEC. 2 * * *

"(a) 'Storage' means and includes any keeping or retention in this State for any purpose except sale in the regular course of business of tangible personal property purchased from a retailer.

"(b) 'Use' means and includes the exercise of any right or power over tangible personal property incident to the ownership of that property, except that it shall not include the sale of that property in the regular course of business."

* * * * * * *

Exempt from the operation of the tax are materials protected from excise by the Federal or State Constitution, and material upon which the California three percent sales tax has been paid.[7] Thus it is observed that the use tax is complementary to the sales tax, being designed to reach purchasers who acquire personal property in other states.

If the property taxed is purchased from a retailer maintaining a place of business within the State of California, the purchaser pays the tax to the retailer and the latter pays it to the State Board of Equalization. If the retailer maintains no place of business within the state, the purchaser pays the board directly. In either case returns and payments are due quarterly (sections 6, 7).

In the event of non-payment the board may file with any county clerk a certificate showing due determination of the tax and the failure to pay. Upon such filing the county clerk is required to enter a judgment for the state against the delinquent. The judgment is subject to execution in the usual manner, and in addition it becomes a lien upon any real property owned by the delinquent within the county (section 20). In addition to this procedure, the board is empowered to bring an action in any court of competent jurisdiction to recover the tax at any time within three years after it becomes due (section 28).

The taxpayer is afforded but one remedy to recover taxes illegally exacted. He may pay under protest and bring an action in the state court.[8]

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[7] "SEC. 4. The storage, use or other consumption in this State of the following tangible personal property is hereby specifically exempted from the tax imposed by this act:

"(a) Property, the gross receipts from the sale of which are required to be included in the measure of the tax imposed by Chapter 1020, Statutes of 1933 and any amendments made or which may be made thereto.

"(b) Property, the storage, use or other consumption of which this State is prohibited from taxing under the Constitution or laws of the United States of America or under the Constitution of this State."

* * * * * * *

[8] "SEC. 29. No injunction or writ of mandate or other legal or equitable process shall issue in any suit, action or proceeding in any court against this State or against any officer thereof to prevent or enjoin under this act the collection of any tax or any amount of tax herein required to be

The bill alleges that the defendants will, unless restrained, take summary action to collect the more than $40,000 alleged to be due upon the property purchased during the quarter ending June 30, 1936. It further states that like or greater amounts of property will be purchased during quarter years to come. Temporary and permanent injunctions are asked against future exactions as well as the claim for the second quarter of 1936.

The defendants' motion to dismiss raises questions which have narrowed to two: (A) Does there exist for the plaintiff an adequate remedy at law? (B) Is the threatened exaction void for repugnance to the Federal Constitution?

(A) We hold that the plaintiff has no adequate remedy at law.

Plaintiff presents several reasons to support its contention that, if the tax is unconstitutional, it has no adequate

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collected; but after payment of any such tax or any such amount of tax herein required to be collected under protest, duly verified and setting forth the grounds of objection to the legality thereof, the retailer or person making the payment may bring an action against the State Treasurer in a court of competent jurisdiction in the county of Sacramento for the recovery of the amount paid under protest. No such action may be instituted more than sixty days after the tax or the amount herein required to be collected and paid to the State becomes due and payable, and failure to bring suit within said sixty days shall constitute waiver of any and all demands against the State on account of alleged overpayments hereunder. No grounds of illegality shall be considered by the court other than those set forth in the protest filed at the time of payment of the tax or the amount herein required to be collected and paid to the State.

"If in any such action judgment is rendered for the plaintiff, the amount of the judgment shall first be credited on any taxes or amounts due from the plaintiff under this act, and the balance of the judgment shall be refunded to the plaintiff. In any such judgment, interest shall be allowed at the rate of six per cent per annum upon the amount found to have been illegally collected from the date of payment of such amount to the date of allowance of credit on account of such judgment or to a date preceding the date of the refund warrant by not more than thirty days, such date to be determined by the Controller.

"In no case shall any judgment be rendered in favor of the plaintiff in any action brought against the State Treasurer to recover any amount paid hereunder, when such action is brought by or in the name of an assignee of the retailer or other person paying said amount, or by any person other than the person who has paid such amount."

legal remedy. It will be necessary to consider only one of the grounds urged, which ground, in our opinion, is controlling.

The Use Tax Act provides but one forum for the recovery by suit at law of taxes paid under protest (Section 29, note 8, *supra*). This forum is "a court of competent jurisdiction in the county of Sacramento". Obviously this provision contemplates a suit only in the state court.

When a bill in equity is brought in a federal court, the test of the adequacy or lack of adequacy of the remedy at law is the legal remedy afforded in the federal court. Where no legal remedy exists in that forum, the remedy at law is inadequate. This conclusion is impelled by a consideration of the nature of the right to sue in the federal courts. It is a substantial constitutional right. Arrowsmith *v.* Gleason, 129 U. S. 86. When one has a cause of action at law, and there exist requisites of federal jurisdiction, his remedy at law is the right to sue in the state or federal tribunal at his election. To deprive him of this choice materially impairs the completeness and adequacy of his remedy.

In Smyth *v.* Ames, 169 U. S. 466, 515, 516, 517, a statute of Nebraska set up a board to prescribe maximum railroad rates. Any railroad deeming itself aggrieved was permitted to bring an action in the supreme court of the state to show that the rates fixed were unjust. If the state court sustained the contention of the railroad it was authorized to issue an appropriate order to the board requiring a correction of the inequity.

Suit was brought by a railroad company in the United States District Court to enjoin the enforcement of the statute. The Supreme Court of the United States held that a case of equity jurisdiction was made out, saying:

> "• • • The adequacy or inadequacy of a remedy at law for the protection of the rights of one entitled upon any ground to invoke the powers of a Federal Court, is not to be conclusively determined by the statutes of the particular State in which suit may be brought. One who is entitled to sue in the Federal Circuit Court may invoke its jurisdiction in equity whenever the established principles and rules of equity per-

mit such a suit in that court; and he cannot be deprived of that right by reason of his being allowed to sue at law in a state court on the same cause of action. • • • 'A State cannot tie up a citizen of another State, having property rights within its territory invaded by unauthorized acts of its own officers, to suits for redress in its own courts'."

In Chicago, B. & Q. Ry. *v.* Osborne, 265 U. S. 14, 16, a railroad company brought suit in the federal court to restrain the collection of taxes levied by the State of Nebraska which taxes were alleged to be unjustly discriminatory. The state law provided a remedy by writ of error to the Board of Equalization from the supreme court of the state. In holding that the taxpayer was authorized to seek federal equity relief, the United States Supreme Court said:

"If an action to recover the payment were allowed, the suit might be brought in the Courts of the United States, under the usual conditions, as well as in those of the State. • • •. But the writ of error, of course, can be sued out only in the State, and a remedy in the State Courts only has been held not to be enough. Smyth *v.* Ames, 169 U. S. 466, 516. St. Louis-San Francisco Ry. Co. *v.* McElwain, 253 Fed. 123, 136. Franklin *v.* Nevada-California Power Co., 264 Fed. 643, 645."

The principle was reaffirmed in Risty *v.* Chicago, etc., Ry. Co., 270 U. S. 378, 388:

"• • • the test of equity jurisdiction in a federal court is the inadequacy of the remedy on the law side of that court and not the inadequacy of the remedies afforded by the state courts. Smyth *v.* Ames, 169 U. S. 466; Chicago B. & Q. R. Co. *v.* Osborne, *supra*."

(B) We hold that the tax sought to be levied upon the plaintiff is an unconstitutional burden on interstate commerce.

The tax in question is laid upon the exercise of certain rights of ownership over personal property; these rights

being enumerated in the broad statutory definitions of "use" and "storage" (footnote 6, *supra*). It is not an *ad valorem* property tax, admittedly valid although the property consists of instrumentalities of interstate commerce, nor is it a tax on the privilege of doing an intrastate business, upheld in Pacific Telephone Co. *v.* Tax Commission, 297 U. S. 403.

The plaintiff does not urge constitutional objections other than the contention that the enforcement here will unduly burden interstate commerce. And even under this heading there can be no objection to the excise on the ground that the materials were imported into the state before the incidence of the tax. Henneford *v.* Silas Mason Co., 300 U. S. 577.

The question narrows, then, to the issue whether at any time after their importation into the State of California, the materials purchased by the plaintiff were not in use in interstate commerce. If they at all times were in actual interstate commerce use or intermixed interstate-intrastate commerce use, that use cannot be subjected to a state tax. It is well settled that such a tax constitutes a forbidden burden on interstate commerce. Helson and Randolph *v.* Kentucky, 279 U. S. 245, 249, 252; Bingaman *v.* Golden Eagle Western Lines, 297 U. S. 626, 628; Cooney *v.* Mountain States Tel. Co., 294 U. S. 384, 393.

By their motion to dismiss the defendants admit the facts pleaded in the complaint. That is, they admit that the items of property they seek to tax "were devoted to the service of transportation immediately upon their purchase", that their financing and accounting was carried on "according to the accounting rules and regulations prescribed for railroads engaged in interstate commerce under the provisions and requirements of the Interstate Commerce Act", that each item was an essential and vital factor in the maintenance and repair of plaintiff's interstate commerce plant, that at all times since their purchase "said materials were allocated and dedicated to sole and exclusive use in interstate commerce and any keeping or retention thereof within the State of California was and is an inseparable part of the use of said materials and each item thereof in interstate commerce."

Thus defendants admit the factual contention that plaintiff's use of the purchased materials at all times since their purchase was a vital use in interstate commerce. Nevertheless they urge that as a matter of law the only interstate commerce use which is free from state taxation is use by way of actual physical consumption or use occurring after the materials have been installed in the operating plant, such as the gasoline being consumed in the Helson and Bingaman cases, or the telephone instruments actually installed in the Cooney case.

The statute specifically exempts property protected from taxation by the Constitution. While this does no more than declare what already is the law, it demonstrates the solicitude of the legislature toward the recognition of constitutional limitations. It indicates that when the legislature defined taxable storage and use it was anxious to insure that interstate commerce use would be protected. Yet defendants would have the statute read:

> "(a) 'Storage' means and includes any keeping or retention in the State * * * of tangible personal property (when such keeping or retention is an inseparable part of the use of such property in interstate commerce, when such property is allocated and dedicated to interstate commerce from the moment of its purchase and is recognized by the Federal Government through the Interstate Commerce Commission as a portion of the capital of the taxpayer used in interstate commerce) * * *."
>
> "(b) 'Use' means and includes the exercise of any right or power over tangible personal property incident to the ownership of that property (which exercise of right or power is a part of the use of such property in interstate commerce prior to a subsequent use by way of consumption) * * *."

We do not believe the statute is thus to be construed. However, if this is the meaning of the act, then we are forced to conclude that it is an unconstitutional exertion of power by the state legislature.

This conclusion is impelled by a realistic approach to the facts presented by the bill. In Pacific Telephone Co. *v.* Tax Commission, 297 U. S. 403, 413, the Supreme Court, dealing with the validity of a state tax, repeated its earlier admonition in Gregg Dyeing Co. *v.* Query, 286 U. S. 472, 480: "The question of constitutional validity is not to be determined by artificial standards."

Whether a use in storage for current consumption is a use in interstate commerce is a question of ultimate fact. Here the court must find or refuse to find this ultimate fact upon the admitted facts and upon those of which it takes judicial notice. It cannot use "artificial standards". It must consider actual business and industrial concepts.

The question is analogous to that presented by a merchandising company's stock for sales in the current season, stored for daily supply of its counters. If such storage is a use other than a merchandising use, what use is it? Or take the case of a canner's stock of cans stored in his plant at the beginning of a fruit season from which stock there is daily withdrawn those required for the arriving fruit. What sort of use is the storage of these cans, if not a canning use?

Certainly any merchandiser or canner or other industrialist or business man would consider it a glaring example of the application of an "artificial standard" to say that such a storage for current consumption was not a use in the business or industry in question. He might well answer: What other business have I in which that storage has any use?

When we view realistically the facts set out in the bill, supplemented with our judicial notice of the practical necessities of a large transportation enterprise, we clearly perceive that this property is used in interstate commerce from the time of its purchase.

Consider first the property purchased for and devoted to a sole, fixed and predetermined use in an existing interstate commerce maintenance program. The storage of such property is a use which is as integral a part of the interstate commerce project as are the rails over which interstate trains are actually running. It is the definite prede-

termined character of its purpose that makes the storage of these purchased articles of equipment as vital to the entire plant before installation as well as afterwards. The situation differs materially from that of the purchase of a body of goods a part or all of which will, in the ordinary turn of events, be used in the future in interstate commerce operations.[9]

It is no answer to say that the plaintiff might change its intention after purchasing and use the property for some purely intrastate purpose not intended at the time of purchase. Granting that such legal right exists, it would be as persuasive to argue that the state might tax the use of an interstate locomotive in operation on the theory that its owner is privileged to use it at any time for a purely local purpose. The question concerns not what the plaintiff might do; it concerns, rather, what the plaintiff is actually doing.

Likewise, property purchased for the sole, fixed and predetermined purpose of serving as "standby" or reserve equipment in an interstate commerce plant is employed in interstate commerce from the time of its purchase. It is almost axiomatic that the far flung system of an interstate railroad cannot be conducted without the presence of reserve supplies. Unpredictable events requiring replacement and repair are of daily occurrence. A flood washes out a section of track. Can it rationally be argued that the rails and ties held in readiness against this emergency are not an integral portion of the company's interstate commerce equipment? One might as well contend that a derail switch is not in use in interstate commerce until an emergency requires it to function.

The distinction which the defendants would have us make between property before and property after installation, whether purchased for an existing necessity or as reserve, strikes us as no more cogent than the argument that the use of a railway station could be taxed because for long periods no interstate trains stop in front of it and no interstate passengers or freight make use of it; or the argument that

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[9] See Nashville, Chattanooga & St. Louis Ry. v. Wallace, *infra*.

the use of a locomotive is taxable by the state during the period in which it is standing idle between interstate trips; or that the telephones held non taxable in the Cooney case, *supra*, should be subject to excise because there were long periods when no interstate calls were being made on any one of them.

In short, a use by way of storage or retention of materials can be fully as vital to interstate commerce as a subsequent use by way of consumption or after installation. A somewhat similar situation is presented by a requirement of pilotage fees which a vessel leaving or entering a harbor must render to a pilot whether or not it avails itself of his services. Pacific Mail S. S. Co. *v.* Joliffe, 2 Wall. 450.

The Federal Government has recognized the interstate character of the use of materials like those described in the complaint through regulations (having the force of law) issued by an administrative agency, the Interstate Commerce Commission.[10] We do not believe that the California Legislature, specifically declaring in section 4 of the Act (note 7, *supra*) its intention to recognize the constitutional prohibition against the taxation of the use of materials in interstate commerce, intended nevertheless to subject to taxation the use of materials not only set apart by the carrier for interstate commerce uses, but recognized as so devoted by the Federal Government.

In a case calling for the determination of whether a particular use of materials is an intrastate or an interstate use, we touch upon the boundary between state and federal

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[10] I. C. C. classification of accounts for steam railroads:

"716. Material and Supplies.

"This account shall include the balances representing the cost, less depreciation, if any, of all unapplied material such as road and shop materials, articles in process of manufacture by the accounting company, fuel, stationery, and dining car and other supplies. In determining the cost of material and supplies suitable allowances shall be made for any discounts allowed in the purchase thereof.

"NOTE.—Balances representing the cost of unapplied construction material and supplies located at the point of use, which have been purchased for projected new roads and extensions, are provided for in road and equipment account No. 47, 'Unapplied construction material and supplies'."

power. The requirement of materials for current repairs and replacement is so obviously a necessity for interstate commerce that no legislation has been needed to compel it. However, the Congress could well pass a statute requiring that:

> "Interstate carriers shall purchase and store for current repairs necessary materials for the efficient conduct of their railways, said *usage* by said carriers of said materials awaiting current installation to be maintained in places convenient to the places of their installation."

To illustrate how our decision in this case may affect the scope of federal power, we assume that the above statute has been passed. In opposition to it we have the instant state use tax act which the defendants would have read:

> "(a) 'Storage' means and includes any keeping or retention in this State for any purpose * * * of tangible personal property (including materials purchased and stored by interstate carriers for current repairs and maintenance necessary for the efficient conduct of their railways) * * *."

The power delegated to Congress under the commerce clause is paramount to the reserved power of the state, when the two come in conflict. Minnesota Rate Cases, 230 U. S. 352, 399; National Labor Relations Board *v.* Santa Cruz Fruit Packing Co. (C. C. A.-9), decided July 31, 1937. Hence in such a conflict of opposing authority presented by the statutes pictured above, this court would be required to indulge every presumption in favor of the Congressional determination that the usage of materials described in both statutes was a use in interstate commerce. Ogden *v.* Saunders, 12 Wheat. 213, 269. Such determination being a reasonable hypothesis, we would be required to accept it as true. Against it the state statute would necessarily fall as invalid. It is because of this possible conflict that we cannot apply the Bushrod Washington doctrine of Ogden

v. Saunders to the state tax legislation challenged in this case.

Conversely, when the state acts within the scope of its reserved powers every presumption is indulged in favor of the validity of its legislation. Such was the case in Pacific Gas & Electric Co. *v.* Sacramento Municipal Utility District No. 8500, recently decided by the Circuit Court of Appeals for the Ninth Circuit.

In support of their contention that the materials in question here are subject to the use tax, the defendants rely strongly on the case of Nashville Ry. Co. *v.* Wallace, 288 U. S. 249, 261, 266. In that case the railroad brought suit in a Tennessee court for a declaratory judgment holding unlawful an excise tax of that state levied upon the storage and withdrawal from storage of gasoline.

The railway purchased the gasoline from points outside the state, brought it into Tennessee and stored it in private tanks. Subsequently all of it was withdrawn from storage to be used as a source of motive power in interstate railway operations. The company assailed the tax both on the ground that the gasoline while stored was still a subject of interstate commerce and on the ground that because of its subsequent use as fuel, the tax was in effect a tax upon the use of the fuel in interstate commerce. The Supreme Court affirmed the highest court of Tennessee in decreeing that the tax was valid. In answer to the railway's first contention it said (p. 266):

> "The gasoline, upon being unloaded and stored, ceased to be a subject of transportation in interstate commerce and lost its immunity as such from state taxation. • • • The fact that the oil was, in the ordinary course of appellant's business, later withdrawn from storage for use, some within and some without the the state, part of it thus becoming again the subject of interstate transportation, did not affect the power of the state to tax it all before that transportation commenced."

In answer to the argument that the tax was one in effect upon the use of gasoline in interstate transportation, it was held (p. 267):

"We cannot say that the tax is a forbidden burden on interstate commerce because appellant uses the gasoline, *subsequent* to the incidence of the tax as an instrument of interstate commerce. Taxes said to burden interstate commerce directly when levied upon or measured by the operation of interstate commerce or gross receipts derived from it, are beyond the state taxing power • • •.

"But interstate rail carriers are not wholly immune from other forms of non-discriminatory state taxation, even though the burden of the tax is thus indirectly or incidentally imposed upon the interstate commerce in which they are engaged. It cannot be doubted that, when the gasoline came to rest in storage, the state was as free to tax it, notwithstanding its *prospective* use as an instrument of interstate commerce, as it was to tax appellant's right of way, rolling stock, or other instruments of interstate commerce, which are subject to local property taxes." (Emphasis supplied.)

Here the Supreme Court makes a finding of ultimate act that the storage was not a use in interstate commerce. The admitted probative facts in that case upon which the inding of ultimate fact was made are not the same as in he instant case. In the case at bar the admitted fact is hat the storage is an *immediate* and not a "prospective se" in interstate commerce.

It is plain from the above quotation that the Supreme Court did not have before it for decision in the Nashville ase the question whether or not the gasoline stored was lready set apart, devoted, and predetermined for use in nterstate commerce before it entered the state. We have tudied exhaustively not only the opinion of the Supreme Court but also the record and briefs in that case. Nowhere lo we find that the gasoline upon entering the State of Tennessee or upon its deposit in the storage tanks was llocated, set apart, and dedicated to interstate commerce ses. Nowhere do we find contention or proof that the tored gasoline was a part of the railroad's current operatng inventory, recognized as such by the Federal Govern-

ment. It was nowhere argued that the gasoline while in the tanks was being used in interstate commerce. As we have already indicated, property is not exempt from state use taxation merely by virtue of the fact that in the ordinary turn of events it will be used in interstate commerce, or the fact that subsequently all of it has been so used. In each case there must be facts, admitted or proved, which show that the keeping or retention is in itself a use in interstate commerce.

What we have said of the Nashville case is equally true of Edelman *v.* Boeing Air Transport, 289 U. S. 249, 251, 253. In that case the taxpayer purchased gasoline within and without Wyoming and stored the same in tanks at its Wyoming airports. It was subsequently withdrawn, some for local sale, some for local use, and some for fueling the taxpayer's interstate airplanes. Wyoming levied an excise tax on the use of gasoline, the incidence of the tax falling on the withdrawal from storage. The taxpayer objected to paying the excise on the fuel withdrawn for interstate planes. The Supreme Court held against the taxpayer, saying that the ruling facts of the case were identical with those in the Nashville decision.

Our examination of the Edelman decision reveals that, as in the Nashville case, there was neither contention nor proof made that the gasoline taxed was set apart or allocated by the taxpayer to an interstate use before it was actually being consumed in the planes; nor any evidence that it was in any way brought under the jurisdiction of the Interstate Commerce Commission. The case is even weaker than the Nashville decision, in view of the fact that when the gasoline was put in storage only an indefinable part of it was subsequently to be used in interstate commerce.

We hold, therefore, that the Nashville and Edelman cases are not controlling on the facts alleged in this complaint. The facts alleged and admitted here bring this case within the principle of the Helson, Bingaman and Cooney cases. In this view it is unnecessary to consider whether the authority of the Nashville and Edelman cases is weakened by Graves *v.* Texas Co., 298 U. S. 393, 401, wherein it was held,

without mentioning the Nashville and Edelman decisions, that a state tax levied on the withdrawal of gasoline from storage for delivery to the United States was void as being an exaction against the activities of the Federal Government.

Reaching a conclusion similar to that of the District Court for Washington, in construing like provisions of a use tax of that state,[11] we hold that the defendants may not constitutionally enforce the provisions of the California Use Tax Act against the plaintiff upon the property set out in the complaint.

The defendants are at liberty, of course, to put the plaintiff to proof of its allegations of present use of the materials as alleged in the bill. And nothing in this opinion bears upon the right of a state to levy a tax upon the intrastate use or property such as that in issue here, under any formula calculated reasonably to apportion the interstate and intrastate commerce uses.

The motion to dismiss the complaint is denied. Plaintiff will be awarded an interlocutory injunction. Plaintiff will prepare and file proposed findings of fact, conclusions of law, and decree.

WILLIAM DENMAN,
U. S. Circuit Judge.
MICHAEL J. ROCHE,
U. S. District Judge.
A. F. ST. SURE,
U. S. District Judge.

[11] Northern Pacific Ry. v. Henneford, 15 Fed. Supp. 302.

APPENDIX "B".

IN THE DISTRICT COURT OF THE UNITED STATES,
NORTHERN DISTRICT OF CALIFORNIA.

IN EQUITY.

No. 4055-R.

SOUTHERN PACIFIC COMPANY, a Corporation, Plaintiff,

v.

JOHN D. CORBETT, FRED E. STEWART, RICHARD E. COLLINS, RAY L. EDGAR, and HARRY B. RILEY, as Members of the State Board of Equalization of the State of California; STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA, and U. S. WEBB, the Attorney General of the State of California, *Defendants.*

Before Denman, Circuit Judge, and St. Sure and Roche, District Judges.

DENMAN, *Circuit Judge:*

This case has been submitted under an agreed statement of facts which sustains the pertinent allegations of the bill discussed in our opinion denying the motion for its dismissal. 20 Fed. Supp. 940.

The railway has established that the storage use of the railway materials, solely for its current repairs and renewals and necessary extensions of its intermingled interstate and intrastate enterprise and plant, and without which usage the railways would stop running, is a use in interstate commerce. Hence a tax upon such use is a tax affecting an interstate commerce use—that is, affecting the federal as distinguished from any state function performed by the railway as a public carrier. At the hearing we invited further argument and briefing, but the able presentation on behalf of the State has not answered the question, "In what enterprise other than the intercommingled interstate and intrastate railroading is this use in storage for current re-

pairs and replacements, without which the railroad could not operate?'' Such storage use for current installation is use in interstate commerce in any realistic sense understood by industrialists and merchants (20 Fed. Supp. 943), and could be regarded otherwise only by the application of some "artificial standard" prohibited by Gregg Dyeing Co. v. Query, 286 U. S. 472, 480.

However, since our denial of the motion to dismiss, the Supreme Court has decided three cases dealing with the boundaries of state and federal taxation. Two of them, Western Live Stock *v.* Bureau of Revenue, 82 L. Ed. 548, and Coverdale *v.* Arkansas & Louisiana Pipe Line Co., decided April 4, 1938, significantly expand the area of the states. A third, Helvering *v.* Mountain Producers Corp., 82 L. Ed. 607, explicitly overrules long established concepts determining the respective taxing areas of both governments.

It is suggested by the state's officers that since the thirteenth paragraph of that decision states

> "• • • In the light of the expanding needs of the State and Nation, the inquiry has been pressed whether this conclusion has adequate basis; whether in a case where the tax is not laid upon the leases as such, or upon the government's property or interest, but is imposed upon the gains of the lessee, like that laid upon others engaged in similar business enterprises, there is in truth such a direct and substantial interference with the performance of the government's obligation as to require immunity for the lessee's income."
>
> Helvering *v.* Mountain Producers Corporation, 82 L. ed. 607, 611,

we may be required to reconsider our decision with a view to the expanding needs for revenue of the State of California, and they offer the enactment of the use tax itself as evidence of such need.

In the present emergency of dependent unemployed, California's need for revenue is of sufficient pressure to produce incandescence, but the emitted light does not show where the path of such a principle of determination will lead us.

What light we have on various interstate railways, performing a National public service as important in the body politic as the circulation of blood in the individual, seems to disclose correspondingly "expanding needs" for revenue to meet their expanding payrolls and interest on debt and, here, expanding taxes. Indeed, so pressing are their needs that only by the expanding use of federal funds is their federally regulated function prevented from transfer to federal courts and federal receivers. Already, for many railways, it has been transferred.

We cannot believe that the language of the Mountain Producers case must be interpreted as imposing on us, first, a determination of the need for state taxation, and, if found, second, a reconsideration of our decision on the denial of the motion to dismiss with a view to a reversal of our holding there. Such a criterion would suggest another review and other overrulings if returning prosperity contracts rather than expands the state's need.

We prefer the alternative view of the state's brief that, just as the emergency of the depression and high rentals in the so-called Rent Cases, Block *v.* Hirsh, 256 U. S. 135; Marcus Brown Holding Co. *v.* Feldman, 256 U. S. 170, and Edgar A. Levy Leasing Co. *v.* Siegel, 258 U. S. 242, and also in the much later case of Home Building and Loan Asso. *v.* Blaisdell, 290 U. S. 398, induced the Congress and the Judiciary to the exploration of hitherto unused constitutional powers, so now the urgency of the more recently expanding functions of government in aid of the economic and social needs of the average man, also made poignantly clear by the world depression, requires both legislatures and courts to review the border line between state and federal taxing areas, as that was decided in cases when no such economic and social conditions existed or had been exposed.

Prior decisions considered in the overrulings by the Mountain Producers case present a more definite guide for determining its effect on the decision of this case. Among the cases considered is Indian Oil Co. *v.* Oklahoma, 240 U. S. 522, holding invalid as an unconstitutional burden on a governmental function a tax on Indian land leases owned by

the taxpayer. Here the tax was on the property itself of the taxpayer.

In three other cases, the *income of the taxpayer* from *his* leases is held not taxable. In Choctaw & Gulf R. R. *v.* Harrison, 253 U. S. 292, was held invalid a state tax on the lessee of a mine from the trustee of the mine for Choctaw and Chickasaw Indian tribes, wards of the federal government, based upon his gross sales of his coal. The court held that the lessee was "the instrumentality through which this (governmental) obligation is carried into effect". Such an agency cannot be subjected to an occupation or privilege tax by a state.

In Gillespie *v.* Oklahoma, 257 U. S. 501, the *state* tax on the income of leases owned by the taxpayer was held invalid on the same reasoning, as was the federal tax on the income of the owner of state leases in Burnet *v.* Coronado Oil & Gas Co., 285 U. S. 393.

In all these cases the tax on the taxpayer's property or his income incidental to its ownership is regarded as potentially destructive of the governmental function served by the taxpayer in the exercise of its ownership.

In the Mountain Producers case the tax was upon the *income* from the leases, and the court states the overruling principle to be:

> "• • • And where it merely appears that one operating under a government contract or lease is subjected to a tax with respect to his profits on the same basis as others who are engaged in similar businesses, there is no sufficient ground for holding that the effect upon the Government is other than indirect and remote. We are convinved that the rulings in Gillespie *v.* Oklahoma, 257 U. S. 501, 66 L. Ed. 338, 42 S. Ct. 171, *supra,* and Burnet *v.* Coronado Oil & Gas Co., 285 U. S. 393, 76 L. Ed. 815, 52 S. Ct. 443, *supra,* are out of harmony with correct principle and accordingly they should be, and they now are, overruled."
>
> Helvering *v.* Mountain Producers, *supra,* 613.

However, preceding this sentence regarding taxation on such *income* is another stating the broader principle permit-

ting taxation on *property* of private persons, formerly regarded as having the character of governmental agents because of their leases or contracts with the government. This statement is so significantly joined by the word "and" to the succeeding above quoted sentence, that we are constrained to believe it to be the broader ratio decidendi of the the case. The preceding sentence is (pp. 612, 613):

> "These decisions in a variety of applications enforce what we deem to be the controlling view—that immunity from non-discriminatory taxation sought by a private person for *his property* or gains because he is engaged in operations under a government contract or lease cannot be supported by merely theoretical conceptions of interference with the functions of government. Regard must be had to substance and direct effect." (Emphasis supplied.)

If, then, the private person dealing with the federal government with reference to his property is subject to state taxation, an occupation tax on that person in the *use* of *his* property would seem equally valid.

If this be so, the principle established is inconsistent with that controlling in Graves *v.* Texas Co., 298 U. S. 393, 401, cited by the Railway as controlling here. There a contractor agreed to sell gasoline to the government. It was *his* property until delivery to the government. Prior to delivery it had to be stored and withdrawn from storage. He was taxed by the state of Alabama for this use of storage and withdrawal while still his property.

The court in the Graves case states that this tax increases the government's cost by the amount of the tax levy. However, it seems clear that because the increased cost is so measurable, the principle is no different from the sales tax on the coal in the Choctaw case. It is just as *certain* that the government will receive less for the coal lease as that it will pay more for the gasoline. One is no more direct than the other. Both are levied on the owners of gasoline and coal while the government has no title in either.

Shortly before the Mountain Producers decision was that in Western Live Stock *v.* Bureau of Revenue, 82 L. Ed. 548.

There a non-discriminatory tax on gross receipts from the sale of advertising in a periodical printed in one state and circulated in that and in other states is held valid as on an intrastate activity. The fact that it increases the cost of producing advertising, which has its value because of its interstate circulation, is not controlling.

The latest of these tax cases, decided April 4, 1938, follows normally the trend of these decisions. In Coverdale *v.* Arkansas & Louisiana Pipe Line Co. the party taxed was engaged in the interstate delivery of petroleum gas through a pipe line. It maintained several pumps in the state of Louisiana, the power from which traveled interstate with the gas it moved. The state levied an occupation tax on the use of the pumps, measured by the amount of power going into an intermingled intra and interstate distribution. The court held that because (1) the tax was non-discriminatory and (2) the pump itself was stationary within the state and itself did not move with the power it created, the tax on its use did not have a *direct* effect on interstate commerce and hence was a valid exercise of the state's right to tax.

When California's use tax on the Railroad is considered in connection with the principles established in the preceding cases, we are compelled to the conclusion that the reasoning on which we distinguished it from the cases of Nashville, etc., Ry. v. Wallace, 288 U. S. 249, and Edelman *v.* Boeing Air Transport Co., 289 U. S. 249, is not controlling. It is true that the standby material here stored for the necessary maintenance of a great interstate railway *is dedicated* to an interstate use, but so are the pumps in the Coverdale case. Railways could not run unless their spare parts and maintenance supplies were used in the storage from which they were currently drawn, but neither could the gas and oil be driven in interstate commerce unless the owner used the pumps.

For the purposes of this case the dividing line is the same as in the Nashville and Edelman cases, even though in those cases there was no proof that the fuel was dedicated to an exclusive use to create power in interstate transportation. It is that the storage use and withdrawal use

are prior to the actual installation of the parts and rails in the locomotive and cars and in the roadbed. Until then the increased cost, although it is paid by the passengers and freight owners, is an "*indirect*" burden on interstate commerce. Did not the Coverdale case seek to distinguish between the Nashville and Edelman cases and Helson *v.* Kentucky, 279 U. S. 345, we should be inclined to hold that the latter case was overruled and, though a direct burden, the tax was as valid as the direct *ad valorem* tax on the railroad's property itself. In logic, as pointed out by Mr. Justice Stone in his concurrence in the Helson case, the one is as justifiable a method of collecting from the railway what it owes the state government for its services in state governmental protection, as is the other.

We find the facts to be as stipulated and agreed by the parties. From those facts we conclude that the threatened enforcement of the California Use Tax Act will not impose a direct or undue burden on plaintiff's interstate commerce business.

The permanent injunction is denied and the bill dismissed.

WILLIAM DENMAN,
United States Circuit Judge.
MICHAEL J. ROCHE,
United States District Judge.
A. F. ST. SURE,
United States District Judge.

May 3, 1938.

[Endorsed:] Statement of jurisdiction. Filed Jun. 21, 1938.